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Tax Pointers for Senior Citizens

All of your Social Security benefits are tax free if your "provisional income," explained at ¶34.3, is $25,000 or less if you are single, or $32,000 or less if you are married and file a joint return. No more than 50% of your benefits are subject to tax if you file a joint return and your provisional income is over $32,000 but no more than $44,000, or if you are single and your provisional income is over $25,000 but no more than $34,000. When provisional income exceeds $34,000 or $44,000 (depending on your filing status), more than 50%, but no more than 85%, of your benefits are subject to tax. If you are married and filing separately, and did not live apart for the whole year, you compute the amount of taxable benefits without considering the base amounts allowed on joint and single returns. The method of computing taxable benefits is explained at ¶34.3.

If you continue to earn wages or self-employed income, you must pay FICA taxes or self-employment tax on that income regardless of your age. Do not confuse this rule with the Social Security benefit rule that allows full benefits for working after you reach age 70; *see* ¶34.5.

Starting in 1997, new tax breaks apply to certain long-term health care expenses and benefits under qualifying policies; *see* ¶17.15.

¶34.1 Special Rules for Senior Citizens

The following special tax rules favor senior citizens:

- ***Higher filing thresholds.*** If you are age 65 or older and single, you do not have to file a return unless your gross income is $7,550 or over. If you are married and you and your spouse are both age 65 or older, a joint return does not have to be filed unless your gross income is $13,400 or over, or $12,600 or over if only one of you is age 65 or older; *see* the chart on page 2 for further details.
- ***Higher standard deduction.*** If you are age 65 or older, you receive an additional standard deduction allowance if you do not itemize deductions. If in 1996 you are single and age 65 or older, you get an additional $1,000, or $800 if you are married or a qualifying widow(er); *see* ¶13.4 for a list of the standard deductions for senior citizens.
- ***$125,000 exclusion for home sellers age 55 or over.*** If you are age 55 or older and sell or exchange your home at a gain, you may avoid tax on profits of up to $125,000 ($62,500 for married persons filing separately). To claim this exclusion you must (1) elect to avoid tax on Form 2119; (2) be age 55 or over on the date of sale; and (3) have owned and occupied the house as your principal residence for at least three of the five years ending on the day of the sale; *see* ¶29.14.
- ***Elderly credit.*** If you are age 65 or older and do not receive Social Security or Railroad Retirement benefits, you may be eligible for a tax credit; the credit is also available to persons under age 65 who are totally disabled; *see* ¶34.7. For example, if you are single, or married but only you are eligible, and receive more than $416 each month from Social Security, you may not claim the credit. If you are married and both you and your spouse are eligible for the credit and file a joint return, you may not claim the credit if you receive more than $625 each month from Social Security.
- ***Social Security benefits.*** If you are married and file jointly, all of your net Social Security benefits are tax free in 1996 if your income is not more than a base amount of $32,000, or $25,000 if your filing status is single, head of household, qualifying widow(er), or if you are married filing separately and did not live with your spouse at any time during 1996. Married persons who file separately and live together at any time during the year are not allowed any base amount; *see* ¶34.3 for computing taxable Social Security benefits.

Social Security Benefits

¶34.2 Social Security Benefits Subject to Tax

If you received or repaid Social Security benefits in 1996, you should receive Form SSA-1099 by January 31, 1997. The form will show the total of paid or repaid benefits. Amounts withheld for Medicare premiums, workers' compensation offset, or attorneys' fees are itemized and included in the total benefits you received. Keep Form SSA-1099 for your records; do not attach it to your return.

The *net benefit* shown in Box 5 of Form SSA-1099 (benefits paid *less* benefits repaid) is the benefit amount used to determine taxable benefits under ¶34.3.

Railroad Retirement benefits. The portion of your Tier 1 Railroad Retirement benefits which is equivalent to Social Security retirement benefits is subject to the computation at ¶34.3 for determining taxable benefits. If any part of your 1996 Tier 1 benefits is equivalent to Social Security benefits, you should receive Form RRB-1099 from the government by January 31, 1997. The *net* Social Security Equivalent Benefit shown on Form RRB-1099 is the amount used to determine taxable benefits under ¶34.3. Other Tier 1 Railroad Retirement benefits, as well as Tier 2 benefits, are treated as pension income and not as Social Security benefits subject to tax.

Benefits paid on behalf of child or incompetent. If a child is entitled to Social Security benefits, such as after the death of a parent, the benefit is considered to be the child's regardless of who actually receives the payment. Whether the child's benefit is subject to tax will depend on the amount of the child's income.

Workers' compensation. If you are receiving Social Security disability payments and workers' compensation for the same disability, your Social Security benefits may be reduced by the workers' compensation. For example, you are entitled to Social Security disability benefits of $5,000 a year. After receiving a $1,000 workers' compensation award, your disability benefits are reduced to $4,000. For purposes of the computation steps of ¶34.3, you treat the full $5,000 as Social Security benefits.

Repayment of benefits. If you lose Social Security benefits because of excessive outside income, the forfeited amount reduces your benefits subject to tax. Form SSA-1099 accounts for this reduction and you report the amount shown in Box 5.

If Box 5 shows a negative amount (a figure in parentheses), none of your benefits are taxable. If the negative amount is related to Social Security benefits included in gross income in a prior year, you may be entitled to a deduction or a credit; *see* IRS Publication 915 for further instructions on how to figure the deduction or credit when your repayments exceed your gross benefits.

Taxable Social Security benefits are not considered earnings and therefore may not be the basis of an IRA contribution (¶8.2), earned income credit (¶25.8), or foreign earned income exclusion (¶36.2).

Nonresident aliens. Unless provided otherwise by tax treaty, 85% of a nonresident alien's Social Security benefits will be subject to the 30% withholding tax imposed on U.S. source income that is not connected with a U.S. trade or business. *See* IRS Publication 519 for further details.

¶34.3 Computing Taxable Social Security Benefits

Before reading the following tax rules, we suggest that you first fill out Worksheet I for listing your benefits and Worksheet II for determining your *provisional income*. Part of your net Social Security benefits will be subject to tax if your *provisional income* exceeds a base amount of $25,000 or $32,000, as discussed in the next column.

Note that on Line 1 of Worksheet II *tax-exempt interest* reported on Line 8b of your return is included as part of provisional income for purposes of figuring the taxable part of your Social Security benefits, although this amount is not included when figuring your regular tax liability.

WORKSHEET I: Personal Status and Benefits Data

Check only one box:

❏ A. Single, head of household, or qualifying widow(er) with dependent child.

❏ B. Married filing a joint return.

❏ C. Married filing separately and LIVED WITH your spouse at ANY TIME during 1996.

❏ D. Married filing separately and LIVED APART from your spouse FOR ALL of 1996.

Your Social Security benefits:

1. Enter net Social Security benefits from Box 5 of SSA-1099 or RRB-1099.	1.______
2. 50% of Line 1.	2.______
3. 85% of Line 1.	3.______

WORKSHEET II: Figuring Your Provisional Income

1. From *Form 1040*, add Lines 7, 8a, 8b, 9 through 14, 15b, 16b, 17 through 19, and Line 21. Do not include Line 20a (net Social Security benefits). Enter the total here. From *Form 1040A*, add Lines 7, 8a, 8b, 9, 10b, 11b, and 12. Do not include Line 13a (net Social Security benefits). Enter the total here.		1.______
2. *Plus:* Tax-free foreign earned income and foreign housing.	______	
Other exclusions.*	______	2.______
3. Add Lines 1 and 2.		3.______
4. *Minus:* Adjustments from Line 30 of Form 1040 other than the foreign housing deduction, or from Line 15c of Form 1040A. Do not include IRA contributions if you are covered by an employer retirement plan; *see* the next page for alternative computation.		4.______
5. Subtract Line 4 from Line 3.		5.______
6. Enter the amount from Line 2, Worksheet I (50% of net Social Security benefits).		6.______
7. Add Lines 5 and 6. This is provisional income.		7.______

*Include exclusions from U.S. savings bond interest, income from U.S. possessions, and income earned from Puerto Rico as a bona fide resident of Puerto Rico.

How Much of Your Benefits Are Subject to Tax?

After figuring your provisional income using Worksheet II, you can use Worksheet III on the next page to compute the amount of your taxable Social Security benefits. The computation steps of Worksheet III reflect the following tax rules:

Benefits are not taxable at all, if your provisional income is $32,000 or less and you checked Box B in Worksheet I, *or* your provisional income is $25,000 or less and you checked Box A or D in Worksheet I.

Neither the $25,000 nor the $32,000 base amount applies if you are married filing separately and you lived with your spouse at any time during the year (Box C, Worksheet I).

Up to 50% of benefits are taxed, if your provisional income exceeds $32,000 but does not exceed $44,000 and you checked Box B in Worksheet 1, *or* your provisional income exceeds $25,000 but does not exceed $34,000 and you checked Box A or D in Worksheet I.

Up to 85% of benefits are taxed, if your provisional income exceeds $44,000 and you checked Box B in Worksheet I, *or* your provisional income exceeds $34,000 and you checked Box A or D in Worksheet I.

Married filing separately. If you are married filing separately and during 1996 you lived with your spouse at any time, you must include in your taxable income the *lesser* of (1) 85% of your net Social Security benefits (Line 3 of Worksheet I) *and* (2) 85% of the provisional income shown on Line 7 of Worksheet II.

IRA contributions. Do *not* use Worksheet I, II, or III if you are an active participant in an employer retirement plan and you plan to make deductible IRA contributions (¶8.4). You must use the worksheets printed in IRS Publication 590. With the worksheets, you first determine the amount of Social Security benefits that would be subject to tax, assuming you did not claim any IRA deduction. That amount is then used to figure the allowable IRA deduction, taking into account any limitations under the phase-out rules (¶8.4), and, finally, the allowable IRA deduction is used to compute the taxable portion of your Social Security benefits.

If you are not covered by an employer retirement plan, you may use Worksheets I, II, and III.

WORKSHEET III: Figuring Taxable Benefits

Check only one box:

❑ A. Single, head of household, or qualifying widow(er) with dependent child.
❑ B. Married filing a joint return.
❑ C. Married filing separately and LIVED WITH your spouse at ANY TIME during 1996.
❑ D. Married filing separately and LIVED APART from your spouse FOR ALL of 1996.

1. Enter Line 7 from Worksheet II (provisional income).	1.________
2. Enter: $25,000 if you checked Box A or D above, or $32,000 if you checked Box B, or -0- if you checked Box C.	2.________
3. Subtract Line 2 from Line 1. If zero or less, enter -0-.	3.________
• If Line 3 is zero, stop. None of your Social Security or Railroad Retirement benefits are taxable.	
• If Line 3 is more than zero, go to Line 4.	
4. Enter 50% of Line 3.	4.________
5. Enter 50% of net Social Security benefits from Line 2 of Worksheet I.	5.________
6. Enter: $34,000 if you checked Box A or D above, or $44,000 if you checked Box B, or -0- if you checked Box C.	6.________
7. Subtract Line 6 from Line 1. If zero or less, enter -0- and go to Line 13 now. Otherwise, go to Line 8.	7.________
8. Enter: $4,500 if you checked Box A or D above, or $6,000 if you checked Box B, or -0- if you checked Box C.	8.________
9. Enter the smallest of Line 4, Line 5, and Line 8.	9.________
10. Multiply Line 7 by 85% (.85).	10.________
11. Add Lines 9 and 10.	11.________
12. Enter 85% of net Social Security benefits from Line 3 of Worksheet I.	12.________
13. **Taxable Social Security (or Railroad Retirement) benefits:** If Line 7 is zero, enter the *smaller* of Line 4 and Line 5. If Line 7 is more than zero, enter the *smaller* of Line 11 and Line 12. Also enter this taxable amount on Line 20b of Form 1040 or Line 13b of Form 1040A. Your net Social Security benefits are reported on Line 20a of Form 1040 or Line 13a of Form 1040A.	13.________

EXAMPLES

1. Frank Adams, who is single, has 1996 earnings of $15,000 from a part-time job, $3,000 of interest income, and $2,000 of dividends. He also receives $8,000 of net Social Security benefits (Box 5 of Form SSA-1099). Completing Worksheet II, Frank's provisional income on Line 7 is $24,000 ($15,000 + 3,000 + 2,000 + 50% of the $8,000 net Social Security benefits). Since $24,000 does not exceed the $25,000 base amount on Line 2 of Worksheet III, none of Frank's Social Security benefits are taxable.

2. Sam and Fran Baker receive in 1996 net Social Security benefits (Box 5 of Form SSA-1099) of $15,000. Their taxable interest, dividends, and capital gains are $20,000, and tax-exempt interest is $10,000. They file a joint return. Their provisional income from Line 7 of Worksheet II is $37,500 ($20,000 + 10,000 + 50% of the $15,000 net Social Security benefits). Since $37,500 exceeds the $32,000 base amount on Line 2 of Worksheet III, part of their Social Security benefits will be taxed. On Worksheet III, Sam and Fran figure that $2,750 of their benefits will be subject to tax:

Worksheet III

1. Provisional income	$37,500
2. Base amount for married persons filing jointly	32,000
3. Line 1 *less* Line 2	5,500
4. 50% of Line 3	2,750
5. 50% of net Social Security benefits	7,500
6. Adjusted base amount for married persons filing jointly	44,000
7. Line 1 *less* Line 6	0

Since provisional income does not exceed the adjusted base amount of $44,000, the instructions for Line 13 of Worksheet III state that the taxable portion of Sam and Fran's benefits is $2,750, the lesser of Line 4 ($2,750) and Line 5 ($7,500).

3. Alice Hall is single and in 1996 has wages of $20,000, dividend income of $7,000, tax-exempt interest of $10,000, and net Social Security benefits of $8,000. Her provisional income (Line 7 of Worksheet II) is $41,000 ($20,000 + 7,000 + 10,000 + 50% of the $8,000 net Social Security benefits). Completing Worksheet III, Alice determines that $6,800, or 85% of her benefits (the maximum under the law), is subject to tax:

Worksheet III

1. Provisional income	$41,000
2. Base amount for single persons	25,000
3. Line 1 *less* Line 2	16,000
4. 50% of Line 3	8,000
5. 50% of net Social Security benefits	4,000
6. Adjusted base amount for single persons	34,000
7. Line 1 *less* Line 6	7,000
8. Statutory test amount for single persons	4,500
9. Smallest of Lines 4, 5, and 8	4,000
10. 85% of Line 7	5,950
11. Line 9 *plus* Line 10	9,950
12. 85% of net Social Security benefits	6,800

The taxable portion of Alice's benefits is $6,800, the lesser of Lines 11 and 12.

4. John and Mary Brown receive in 1996 $31,000 in wages, $12,000 in dividend income, and net Social Security benefits of $18,000. Their provisional income is $52,000 ($31,000 + 12,000 + 50% of $18,000 of net Social Security). Completing Worksheet III, John and Mary determine that $12,800 of their benefits is subject to tax:

Worksheet III

1. Provisional income	$52,000
2. Base amount for married persons filing jointly	32,000
3. Line 1 *less* Line 2	20,000
4. 50% of Line 3	10,000
5. 50% of net Social Security benefits	9,000
6. Adjusted base amount for married persons filing jointly	44,000
7. Line 1 *less* Line 6	8,000
8. Statutory test amount for joint returns	6,000
9. Smallest of Lines 4, 5, and 8	6,000
10. 85% of Line 7	6,800
11. Line 9 *plus* Line 10	12,800
12. 85% of net Social Security benefits	15,300

The taxable portion of John and Mary's Social Security benefits is $12,800, the smaller of Line 11 and Line 12.

¶34.4 Election for Lump-Sum Social Security Benefit Payment

If in 1996 you receive a lump-sum payment of benefits covering prior years, you have a choice: (1) You may treat the entire payment as a 1996 benefit taxable under the rules of ¶34.3; *or* (2) you may allocate the benefits over the taxable years in which they were payable. Choose the method that provides the lowest required increase to income in the current year. For example, if you receive a lump-sum payment that includes benefits for the previous year, you may find that an allocation of benefits is advantageous where your income over the two-year period has fluctuated and benefits allocated to the prior year would be subject to a lower taxable percentage than in the current year.

When you elect to allocate benefits to a prior year, you do not amend the return for that year. You compute the increase in income (if any) that would have resulted if the Social Security benefits had been received in that year. You then add that amount to the income of the current year.

See IRS Publication 915 for instructions on how to allocate and report the allocated income on your return.

¶34.5 Retiring on Social Security Benefits

Benefits are not paid automatically. You must register at the local Social Security office three months before your 65th birthday to allow time for your application to be processed and to locate all necessary information. Even if you do not plan to retire at age 65, you must register to insure your Medicare coverage.

If you retire before age 65, you may elect reduced Social Security benefits. The reduction formula is based on the number of months before age 65 that you retire. If you retire at the earliest age, 62, the reduction is about 20%.

If you do not retire at age 65, your potential Social Security benefit increases for each year you delay retirement. The increase is 4½% per year for those born in 1929 or 1930, 5% for those born in 1931 or 1932, and 5.5% for those born in 1933 or 1934.

Benefits may be reduced because of earnings. If you are under age 70, Social Security benefits are reduced by earned income (wages and self-employment income). If you were age 65 or older but under age 70 in 1996, you could earn $12,500 without losing benefits. If you were under age 65 for the whole year, you could earn $8,280 without losing benefits. These ceilings are subject to annual inflation adjustments. Once you earn more than these ceilings, benefits are reduced. If you are age 65 or over and under age 70, you lose $1 in benefits for each $3 you earn above the earnings ceiling. If you are under age 65, $1 of benefits is lost for every $2 of excess earnings. In the year of retirement, a special monthly earnings ceiling applies.

For those age 70 or over, benefits are not reduced by earnings. You can work, earn any amount, and receive full Social Security benefits.

So long as you continue to work, you pay Social Security taxes on your earnings, regardless of your age.

Regardless of your age, you may receive any amount of income from sources other than work—for example, private pensions or investments—without affecting the amount of Social Security retirement benefits.

Request an estimate of benefits and copy of earnings record. You can get an estimate of retirement benefits by sending for Form SSA-7004. After mailing in a completed Form SSA-7004, you will receive a Personal Earnings and Benefit Estimate Statement, showing your earnings history, Social Security tax payments, and an estimate of your retirement, disability, and survivor's benefits.

Form SSA-7004 is available at your local Social Security office. You can also request the form from the Social Security Administration by calling 1-800-772-1213.

¶34.6 How Tax on Social Security Reduces Your Earnings

There is an added tax cost of earning income if the earnings will subject your Social Security benefits to tax. Therefore, if your benefits are not currently exposed to tax, you have to figure *not only* the tax on the extra income *but also* the amount of Social Security benefits subjected to tax by those earnings. If the additional earnings will put you over the base amount (¶34.3), then you will not only have to pay tax on the additional earnings but also on the Social Security benefits that will be subject to tax. As a result, the marginal tax rate on the extra income will be higher than the regular rate that would otherwise apply; *see* Example 2 below.

EXAMPLES

1. You are over age 70 and you and your spouse receive net Social Security benefits of $8,000. You file jointly. You have pension income of $25,000 and $3,000 in tax-exempt interest. Your provisional income (¶34.3) is $32,000. No part of your Social Security benefits is taxable because your provisional income of $32,000 does not exceed the $32,000 base amount for married persons filing jointly.
2. Same facts as in Example 1, except that you take a part-time job paying $8,000. This increases your provisional income to $40,000 and subjects $4,000 of Social Security benefits to tax.

Provisional income	$40,000
Less: Base amount	32,000
Excess	$ 8,000
50% of excess taxable (¶34.3)	$ 4,000

The $8,000 of additional earnings increased your taxable income by $12,000, which is the $8,000 of earnings plus the $4,000 of Social Security benefits made taxable because of the increase in provisional income. Assuming a 15% tax rate, the

tax on the $12,000 is $1,800 ($12,000 × 15%); the effective tax rate on the $8,000 earnings is 22.5% ($1,800 ÷ $8,000), rather than 15%. If you consider employment taxes, the effective tax rate is higher; *see* below.

When earnings result in forfeiture of Social Security benefits. If you are under 70 years of age, it is possible under the current tax structure to earn extra income and yet have only a small gain or even lose money when considering the increased tax on the earnings and on Social Security benefits, and also the forfeiture of benefits when earnings exceed the annual retirement earnings test; *see* ¶34.5.

Therefore, before taking on work to earn extra income, you should compute the tax cost of the extra earnings and the loss of benefits. As a rule of thumb, you may figure the extra tax cost by multiplying the earnings by your top federal tax bracket and also by the FICA tax rate of 7.65% (Social Security and Medicare withholdings) and by your top rate for state or local taxes. But be aware that this composite rate ignores the effect of the increased tax from crossing the thresholds for taxing up to 50% or 85% of Social Security benefits. Therefore, in such cases, the tax cost will be greater than the estimated composite tax rate. For greater accuracy, figure your tax position as if you were preparing two tax returns: one which does not include the extra income and the other which does include the extra income. The tax difference is the extra income tax cost of earning the extra pay. Add to this cost the FICA tax on the extra earnings and any additional state or local taxes. Then figure the amount of benefits that will be forfeited. This will give you a net gain or in some cases a net loss. If you have a tax consultant, it may be advisable to ask the consultant to make the computations.

EXAMPLE

A widower, age 66, has annual pension and other income of $18,780, net Social Security benefits of $12,000, and itemized deductions of $5,950. During the summer of 1996, he earned wages of $12,500, the Social Security earnings limit (¶34.5) in 1996 for those age 65–69 before benefits are reduced. If he continued to work, he would begin to forfeit Social Security benefits: $1 of benefits for every $3 of earnings over $12,500. He estimated that in the remainder of the year, he could earn an additional $12,000 by continuing to work. Before making his decision, he made the following computation and learned that he would have only a net gain of $2,910 from the extra pay of $12,000. The increased federal taxes and loss of benefits substantially exceeded that gain. He would lose benefits of $4,000 and pay an additional federal income tax of $4,172 and FICA tax of $918. His net would be even less, if he had to pay a state or local income tax on the extra pay. Earning more wage income also increased the amount of Social Security benefits subject to tax. In the Example, the increase was $2,912. For purposes of the Example, the steps of computing taxable Social Security benefits have been slightly condensed; the complete steps may be found at ¶34.3. By earning $12,000 more, taxable income increases by $14,912 ($12,000 *plus* $2,912).

For purposes of the Example it has also been assumed that the additional earnings are not reported to the Social Security Administration until the following year when the annual earnings report is filed. Thus, the regular benefits of $12,000 for 1996 are not reduced in 1996. Repayment of the forfeited benefits will occur in 1997.

Computing taxable Social Security benefits before extra earnings:

1. Gross income before benefits	$31,280
2. 50% of net benefits	6,000
3. Provisional income	37,280
4. Line 3 *less* $25,000 base for single persons	12,280
5. 50% of Line 4	6,140
6. Line 3 *less* $34,000 adjusted base for single persons	3,280
7. Statutory amount for single persons	4,500
8. Smallest of Lines 2, 5, and 7	4,500
9. 85% of Line 6	2,788
10. Total of Lines 8 and 9	7,288
11. 85% of net benefits	10,200
12. Lower of Line 10 and Line 11 is the taxable benefits	7,288
Federal tax position:	
Wages	$12,500
Other income	18,780
Taxable Social Security benefits	7,288
Adjusted gross income	38,568
Less: deductions and personal exemption	8,500
Taxable income	$30,068
Federal tax liability	$5,301

Computing taxable Social Security benefits after extra earnings:

1. Gross income before benefits	$43,280
2. 50% of net benefits	6,000
3. Provisional income	49,280
4. Line 3 *less* $25,000 base for single persons	24,280
5. 50% of Line 4	12,140
6. Line 3 *less* $34,000 adjusted base for single persons	15,280
7. Statutory amount for single persons	4,500
8. Smallest of Lines 2, 5, and 7	4,500
9. 85% of Line 6	12,988
10. Total of Lines 8 and 9	17,488
11. 85% of net benefits	10,200
12. Lower of Line 10 and Line 11 is the taxable benefits	10,200

Federal tax position:	
Wages	$24,500
Other income	18,780
Taxable Social Security benefits	10,200
Adjusted gross income	53,480
Less: deductions and exemptions	8,500
Taxable income	44,980
Federal income tax	$9,473
Less: income tax before increased earnings	5,301
Tax attributable to increase	4,172

Tax Credit for the Elderly and Disabled

¶34.7 Claiming the Credit for Elderly and Disabled

You may qualify for a tax credit for 1996 if you meet one of the following conditions:

- Your 65th birthday is on or before January 1, 1997; *or*
- You were under age 65 at the end of 1996, you retired before the end of 1996 because of permanent and total disability and you received taxable disability income in 1996 from your former employer's disability plan. Disability income is taxable wages or payments in lieu of wages paid to you while absent from work because of permanent and total disability. Qualifying disability income does not include payments received after reaching mandatory retirement age.

Disabled. You are considered permanently and totally disabled if you are unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than 12 months.

For the first year you claim the credit, you need a physician's certification of your disability. For later years, new certifications are generally not required.

Nonresident aliens. You may not claim the credit if you are a nonresident alien at any time during 1996, unless you are married to a citizen or resident and you have elected to be treated as a resident; *see* ¶1.8.

Amount of credit. The amount of the credit is 15% times the base amount after reductions. The base amount for the credit is generally $7,500, $5,000, or $3,750, as shown in ¶34.8. The base amount is reduced by nontaxable Social Security and other tax-free pensions, as well as by adjusted gross income exceeding specific limits as explained in ¶34.9.

How to claim the credit. You claim the credit on Schedule R if you file Form 1040. If you file Form 1040A, claim the credit on Schedule 3. You may not claim the credit on Form 1040EZ.

The credit is not refundable. That is, it is allowed only up to your tax liability. Furthermore, the credit may be limited if you have tax adjustments or preference items subject to alternative minimum tax (¶23.6), even though you are not actually subject to AMT because of the AMT exemption. Follow the tax form instructions.

Married couples. A married couple may claim the credit only if they file a joint return. However, if a husband and wife live apart at all times during the taxable year and file separately, the credit may be claimed on a separate return.

¶34.8 Base Amount for the Credit

The law fixes an initial base amount for figuring the credit. This base amount is reduced by certain tax-free benefits and excess adjusted gross income; *see* ¶34.9. The credit is 15% of the base amount after reductions.

The initial base amount is:

- $5,000, if you are single, head of household, or are a qualified widow(er).
- $5,000, if you file a joint return and only one spouse is eligible for the credit.
- $7,500, if you file a joint return and both spouses are eligible for the credit. The credit is figured solely on this base; a separate computation is not made for each spouse.
- $3,750, if you are married and file a separate return. The credit may be claimed on a separate return only if you and your spouse have lived apart at all times during the year.

Base amount if disabled. If you are under age 65 and permanently and totally disabled, the base amount for figuring the credit is the *lower* of your 1996 disability income and the initial base amount for your filing status shown above. For example, if you are single, under age 65, permanently and totally disabled, and received disability income of $4,800, you figure the credit on $4,800, which is less than the base of $5,000 for single persons.

Joint return and both spouses qualify for the credit. If one spouse is age 65 or over and one spouse is under age 65 and receives disability income, the initial base amount is the lesser of (1) $7,500 and (2) $5,000 *plus* the disability income of the spouse under age 65. If both spouses are under age 65 and disabled, the initial base amount is the total of their disability income, not exceeding $7,500.

¶34.9 Reduction of Base Amount

The base amount (¶34.8) is reduced by nontaxable pensions and Social Security, and also by "excess" adjusted gross income, figured as follows:

Nontaxable Social Security and pensions. The base amount is reduced by:

- Social Security and Railroad Retirement benefits which are *not taxable* under rules of ¶34.3; and
- Tax-free pension, annuity, or disability income paid under a law administered by the Veterans' Administration or under other federal laws.

You do *not* reduce the base amount for: military disability pensions received for active service in the Armed Forces or in the Coast Guard and Geodetic Survey or Public Health Service; certain disability annuities paid under the Foreign Service Act of 1980; and workers' compensation benefits. However, if Social Security benefits are reduced by workers' compensation benefits, the amount of workers' compensation benefits is treated as Social Security benefits that reduce the base.

Excess adjusted gross income. You reduce the base amount by one-half of adjusted gross income (AGI) exceeding: $7,500 if you are single, head of household, or a qualified widow(er); $10,000 if you are married filing a joint return; or $5,000 if you are married and file a separate return. Applying these income floors, the credit is no longer available to a single person when AGI reaches $17,500, or $20,000 on a joint return where one spouse is eligible for the credit, and $25,000 where both spouses are eligible for the credit.

EXAMPLES

1. A single person over age 65 has adjusted gross income (AGI) of $9,000 and receives Social Security benefits of $4,200 which are not taxable under ¶34.3. His credit is $7.50.

Initial base amount (¶34.8)	$5,000
Less: nontaxable Social Security	4,200
	$ 800
Less: 50% of AGI over $7,500	750
Credit base	$ 50
Credit (15%)	$ 7.50

2. A married couple, both spouses over age 65, file a joint return showing adjusted gross income of $12,000. They received Social Security benefits of $5,000, which are not subject to tax.

Initial base amount (¶34.8)	$7,500
Less: nontaxable Social Security	5,000
	$2,500
Less: 50% of AGI over $10,000	1,000
Credit base	$1,500
Credit (15%)	$ 225

Continuing Care Communities

¶34.10 Tax Effects of Moving to a Continuing Care Facility

Senior citizens who move into "continuing care" or "life-care" facilities pay large upfront entrance fees upon admittance, as well as monthly fees thereafter in return for a residence, meals, and lifetime health care, including long-term skilled nursing care, should that become necessary. The payments raise several tax issues discussed in this section and in ¶34.11.

Portion of monthly fees deductible as medical expense. Part of the monthly fees to a life-care community are allocable to health care, which you may deduct as an itemized medical expense subject to the 7.5% floor; *see* ¶17.4. Continuing care facilities generally send a statement to the residents specifying what portion of their monthly service fees went towards health care.

What about the upfront payments required by life-care communities? Part may be allowable as a medical expense deduction if you can prove what part of the lump sum is allocable to future medical coverage. The IRS recognizes that a deduction may be based on a showing that the life-care facility historically allocates a specified percentage of the fee to future medical care. With such proof there is a current obligation to pay and the allocable medical expenses are deductible when the lump sum is paid. The IRS has allowed deductions in the situations described in the Examples at ¶17.11.

Charitable contribution deductions. Payments made to a tax-exempt organization that operates a life-care community are generally not deductible charitable contributions because you are receiving services in exchange. If you donate amounts over and above your regular monthly fees and do not receive any extra benefit as a result, you may deduct the excess payment as a charitable contribution; *see* ¶14.16.

In one case, an individual was allowed by the Tax Court and an appeals court to claim a charitable contribution deduction for a "sponsorship gift" paid to a life-care retirement facility where she and her husband were residents. The sponsorship gift was entirely separate from her entrance fee; it was not required for admission and did not entitle her to reduced monthly payments. She did not receive any extra benefit from her gift and was not entitled to a refund of any part of it.

Home sale prior to entering a care facility. If you sell a home and move into a life-care community, you generally may not defer tax on the sale by claiming that the entrance fee is the equivalent of buying a new residence. The IRS has ruled that an investment in a retirement community is not the same as buying an actual home.

In some retirement communities, you may be able to purchase an actual condominium or co-op unit as part of the arrangement entitling you to lifetime care. In that case, tax deferral on a prior home sale would be allowed if the cost of the new unit was as much as the adjusted sales price of the old house under the rules of ¶29.5. Furthermore, sale of the new unit would qualify for the $125,000 exclusion if you have not previously claimed an exclusion and you live in the new unit for at least three of the five years before the sale; *see* ¶29.14.

¶34.11 Imputed Interest on Refundable Entrance Fees

You must pay a lump-sum entrance fee when you enter a continuing care community. Depending on the type of plan, a portion of the lump-sum fee may be refundable either to you if you move from the community or to your heirs upon your death. The payment of the fee may also reduce your monthly charges.

These features may result in an unexpected tax liability under the imputed interest rules. Part of the refundable entrance fee is considered a "loan" to the continuing care facility, so that imputed interest income may be charged to you under the rules of ¶4.31. According to Congressional committee reports, these loan rules do *not* apply, and thus the imputed interest rules do not apply, to limited refund plans, under which the entrance fee is refundable on a declining pro rata basis over a relatively short number of years.

In applying the imputed interest rules, the tax law distinguishes between qualified and nonqualified continuing care facilities. The tax treatment of nonqualified facilities is currently in a state of limbo. The IRS has delayed ruling on the tax treatment of entrance fees to nonqualified facilities so that the imputed interest rules will not be applied until the IRS releases regulations requiring tax and explaining how to compute the amount of imputed interest. The tax treatment of qualified facilities is specifically covered by law and is explained in the following paragraphs. Generally, qualified care facilities provide long-term nursing care if and when a resident becomes incapacitated. A nonqualified facility provides only limited short-term care which may be as short as 30 days.

Qualified continuing care facilities. The "loan" portion of an entrance fee of a qualified continuing care facility is not subject to imputed interest unless it exceeds an annual floor. For 1996, refundable loans of up to $127,800 are exempt from the imputed interest rules provided that (1) you or your spouse were at least age 65 during the year; and (2) the care facility provides a separate living unit, meals, maintenance, routine medical care, and, if it later becomes necessary, future long-term nursing care for no substantial additional charge. Incoming residents must not initially require long term nursing care, but such care must be provided when it becomes necessary. A traditional nursing home is not a qualified continuing care facility. The $127,800 exception is subject to increases for inflation.

Since only the refundable portion of the fee is treated as a loan, the larger the payment or refund percentage is, the greater the potential imputed interest liability is. For example, in 1996, you and your spouse paid $155,000 for a two-bedroom apartment. If your guaranteed refund percentage is 75%, the imputed interest rules would not apply in 1996 because the "loan" or $116,250 (75% of $155,000) is below the $127,800 floor. However, if the refund percentage is 85%, the loan is $131,750 (85% of $155,000), and the $3,950 excess over the $127,800 floor is subject to imputed interest.

If imputed interest applies, the care facility should give you a Form 1099 indicating the taxable amount.